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The political economy of industrialisation

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Abstract

This paper analyses how incentives under different sets of political institutions map into policies that promote industrialisation. I set out an endogenous growth model with non-overlapping generations, where agents are heterogeneous with respect to wealth, skills and political power. The skills of the political elite play a crucial role for industrialisation to occur. It is shown that a flat wealth distribution and a skilled political elite enhance development the most in elitist regimes, while democracies perform as well as elitist regimes in terms of industrialisation. The theoretical results regarding elitist regimes are in line with evidence on the Industrial Revolution.

JEL classification: O14; O41; N10; H11
Keywords: Ability; Franchise; Industrial revolution

1. Introduction

At least since the time of Plato, there has been ongoing discussion about the optimal form of political governance. Should a state be run by the many or the few, and what characteristics should decisive agents possess to most enhance development? From an economic point of view, these questions are of particular interest when a country stands before large structural transformations, such as industrialisation.

This paper investigates how incentives under different sets of political institutions map into policies promoting industrialisation. The story is the following. New inventions and innovations can, at times, be of such magnitude that they revolutionize the economy. However when technologies are new and not fully developed, it can be difficult to discern their poten-

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tial. Therefore, the political elite must be able to realise the potential of new technology, so that it supports public investment in institutions necessary for industrialisation to occur swiftly. The characteristics of the ruling class are in this sense crucial for development. If only the rich are enfranchised, they may have to impose heavy taxes on themselves to finance the public investment necessary for industrialisation. But, the governing class will, of course, implement such taxes only if it gains more than it loses from industrialisation, i.e. if the elite is able to realise the income potentials of the new technology. In democracies, the situation is different in that what matters are the characteristics of the decisive voter rather than of a governing elite. Here it is the ability of the decisive voter that is crucial, since the more skilled he or she is, the more positively inclined to financing infrastructure he or she will be.

In this paper I suggest that the government (controlled by an elite or through a pivotal voter) must have the ability as well as the incentives to promote the industrialisation process. In the initial stages of a structural transformation, skillful government is required to grasp and defend upcoming opportunities from vested interests in old technology. The promptness of the British government to resist the Luddite revolts in 1811–1813 is an example. More soldiers protected the embryonic factories than those who were sent to fight against Napoleon in 1808.[1]

In the theoretical model, political regimes differ with respect to franchise rules. All agents are enfranchised in democracies, while there are wealth restrictions on voting in elitist regimes. Elections determine the size of public investment, which is necessary for industrialisation. The opportunity for industrialisation is created by an exogenous shock that makes it profitable to invest in a new skill-intensive sector, as long as there is complementary public investment. In this new sector, the return to investment depends on the investing agent's skill level. It is assumed that credit markets are imperfect, as bankers are too risk-averse to lend for investment in the new and unknown technology.[2] During a transition period, the traditional and the new sector coexist and individuals must make private investment decisions depending on their skill and wealth endowments and on the political outcome.

Historical data from 1820 to 1913 for 23 countries is used to interpret the model. During this historical period, the Industrial Revolution changed the production structure of several, but not all, economies, and this period of time therefore an appropriate epoch for confronting the implications of the model with data. In 1820, there were wealth restrictions to voting in all countries, hence it is only possible to study initially elitist regimes. The empirical evidence on the Industrial Revolution is therefore used to study whether the theoretical implications of the importance of the elite's skill and wealth distribution are reflected in countries' industrialisation and democratisation patterns. Preliminary evidence supports the model's prediction that economies with a skilled elite and a flat wealth distribution should be the first to industrialise. Moreover, the distribution of ability in the population appears to be significantly correlated with measures of the degree of industrialisation in a country, indicating that the basic story of this paper is empirically relevant.

[1] See Mokyr (1990), p. 257, for more details.

[2] This paper does not aim at capturing the situation in developed countries, but rather the transformation from an agrarian to an industrialised economy. In this case, severe credit restrictions on the poor in such societies are likely to exist. Taking the example of the Industrial Revolution, capital markets were certainly highly unavailable for the poor. The situation is improving today with, for example, the Grameen bank, but credit restrictions are still likely to be binding for poor people wanting to invest in new technology.